No. 9242

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

West Coast Life Insurance Company (a corporation), Pacific National Bank of San Francisco (a national banking association), et al.,

Appellants,

vs.

Merced Irrigation District and Reconstruction Finance Corporation,

Appellees.

REPLY BRIEF OF APPELLANT, MINNIE RIGBY, ET AL.

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Table of Authorities Cited

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REPLY BRIEF OF APPELLANT, MINNIE RIGBY, ET AL.

Pursuant to special permission appellants, Minnie Rigby and Richard tum Suden, as executrix and executor of the estate of William A. Lieber, deceased, herewith submit a reply directed to and in traverse of the statement in appellee's brief wherein it minimizes consideration of the legal effect of the several late decisions of the Supreme Court of the State of California.

It is the purpose of this brief to present for the Court's convenience the importance of those decisions by quotations therefrom.

Responding to the statement in appellee's brief (p. 84), where it is said: "The late California decisions do not purport to state any new rule", it is respectfully urged and submitted that the Court did firmly establish several fundamental rules, subsequent to the Bekins opinion (304 U. S. 27), in which it held for the first time positively that Irrigation Districts are Agencies of the State "whose functions are considered *exclusively governmental.*"

Also the State Supreme Court held subsequent to the Bekins opinion, that the District's power of taxation, right to impose charges for water and electric energy, and that all of its properties, duties, rights and revenues constitute an irrevocable "Public Trust". Also that the full rental value of land within the District boundaries, both urban and rural, constitutes a part of this "Public Trust". Also that the Statute does not begin to run against any presented bond or coupon, until the money necessary to pay has been collected, and notice given. Also that all property, both real and personal owned by the District, no matter how acquired or used, is State owned, and therefor exempt from taxation by a County, and it is also exempt from execution by any creditor.

The *U. S. v. Bekins* opinion (supra) came down on April 23, 1938.

On November 28, 1938, the California Supreme Court determined for the first time in *El Camino Irr. Dist. v. El Camino Land Corp.,* 12 Cal. (2d) 378 at 383, as follows:

"Defendant has attempted to lump together all public bodies and agencies, and to make the characterization of governmental or proprietary use applicable to all. But the cases make a sharp distinction between municipal corporations, such as the cities in the Kubach Co. and Marin Water and Power Co. cases, and *state agencies such as irrigation* or reclamation districts. These latter are agencies of the state whose functions are considered *exclusively governmental;* their property is *state owned,* held *only for governmental purposes;* they own no land in the proprietary sense, within the rule of defendant's cases. (Citing cases.) Once it is established that the property is *owned by the state* or its agency, rather than by a municipal corporation, the rule of the Kubach Co. case becomes inapplicable." (Emphasis ours.)

Also on November 28, 1938, the Court ruled in the case of *Provident Irr. Dist. v. Zumwalt,* 12 Cal. (2d) 365 at 375 as follows:

"But laying aside quibbles as to the exact meaning of the phrase 'uses and purposes', it seems clear that to function on borrowed money, repayment of the money is not a wholly immaterial and foreign objective. Evading creditors is not a contemplated activity of a public district, whose bonds are recognized investments for financial institutions. Among other purposes of the act, therefore is the repayment of the bondholders of the district, and it follows that this is one of the purposes for which the *trust money* is held.

This view is fortified by a consideration of the general plan of the statute, in so far as it pro-

vides for the creation of an obligation and a procedure for payment. The land is the ultimate and only source of payment of the bond. *It can never be permanently released from the obligation* of the bonds until they are paid. The release from liability for assessments while the district holds title is intended to be temporary only, and the liability for new assessments is again imposed when it goes back into private ownership. *Any practice* which removes the land as ultimate security for the bonds, or which places its proceeds beyond the reach of the bondholders, destroys that plan and is contrary to the spirit of the act. And the practice employed by the district herein does exactly that. Theoretically and formally the remedies of the bondholders remain unaltered. Actually they have been destroyed. Economic conditions have placed the land outside of the power of assessment for payment of the bonds. But it is the act of the directors alone which has taken the *proceeds* of the land from the bondholders. This use of the funds, contrary to the whole intent of the act, is in our opinion in violation of the *trust impressed on the land* under Section 29. * * * We assume, for the purposes of this case, that the directors, in their discretion, may determine that some of the proceeds of *leasing* of lands are essential to operation and maintenance, and may use them for these purposes. But any surplus, over and above operating expenses, *remains subject to the trust,* and should go to the payment of bondholders." (Emphasis ours.)

Also on November 28, 1938, the California Supreme Court said in *Moody v. Provident Irr. Dist.,* 12 Cal. (2d) 389 at 395:

"That the annual assessments and the sale of the lands upon which the assessments are not paid may never realize sufficient money to pay the indebtedness of the district is entirely beside the question. The property of the district, so far as it owns any property, constitutes *a public trust* and is held by the district for *a public use,* and, therefore, is *not subject* to levy and sale upon *execution* by a creditor of the district. (Citing cases.) That the *statute of limitations,* under the circumstances disclosed by this case, could *never* be pleaded by the district until it had the money in its possession to pay the bonds belonging to plaintiff, and had given notice, is supported by the case of Freehill v. Chamberlain, 65 Cal. 603, 4 Pac. 646 * * *." (Emphasis ours.)

Other important points of law were clarified and determined, the same day in the case of *Clough v. Compton-Delevan Irr. Dist.,* 12 Cal. (2d) 385, where the Court held the trust is not subject to partition by a creditor.

Shortly after these cases, the Court ruled in *Anderson-Cottonwood Irr. Dist. v. Klukkert,* 13 Cal. (2d) 191, that no land owned or held by Irrigation Districts is subject to taxation by a County. On the same date, it was held in *Glenn-Colusa Irr. Dist. v. Ohrt,* 31 C. A. (2d) 618, that grain owned by an Irrigation District, received in lieu of cash rent for the right to cultivate district owned land (acquired for uncollected assessments), is not taxable by a County.

In the light of these sweeping decisions, all of which came down after the Bekins opinion, and ac-

cording to the rules determined in the *Erie R. R. Co. v. Tompkins,* 304 U. S. 64, and in *C. M. & St. P. & P. R. Co. v. Risty,* 276 U. S. 567, where the Court said:

> "Since our decision in Risty v. C. R. I. & P. R. Co., supra, the Supreme Court of South Dakota in State v. Risty, ... S. D. ....., 213 N. W. 952, has had occasion to pass upon the construction and constitutionality of the South Dakota Drainage statutes, taking a different view from that of this court and the lower courts. * * * *This construction* of the state statutes by the highest court of the state, *we, of course, accept.*" (Emphasis ours.)

there can, we respectfully submit, exist no power whatever under the Constitution to directly or indirectly subject the taxing and borrowing powers of such a State Governmental Agency, or its public bonds, either with or without the *ex-post facto consent* of a State and some creditors, to the bankruptcy powers of the Congress.

Furthermore, Section 83(i) explicitly exempts these powers from the Act. There was no power or authority, either express or implied in the State law, under which these bonds were issued to render them subject to bankruptcy, insolvency or re-organization, whether under State or Federal authority.

We find nothing in the Ashton majority or minority opinions, nor in *U. S. v. Bekins,* which suggests that the taxing or borrowing powers of a State or its Governmental Agencies are subject to the bankruptcy clause.

The revenues which Merced Irrigation District is authorized and directed by State law to collect, by methods other than the levy of unlimited annual ad valorem taxes or assessments against all land, both urban and rural within its boundaries (exclusive of improvements), include charges for water (both domestic and agricultural), electric energy, and the rent for district owned land, all of which relieve the State of the necessity of levying direct taxes for these State owned public improvements, for which the State called the agency into existence, and all of which funds, in excess of operation and maintenance expenses, are declared a "Public Trust", and irrevocably pledged to pay the bonds of appellants.

Stearns v. Minnesota, 179 U. S. 223;
Moody v. Prov. Irr. Dist., 96 Cal. Dec. 512.

Under the construction and application of Section 81 submitted by appellee, the "Public Trust", irrepealably created by the State, for the uses and purposes of the Irrigation District Act (one of which is the payment of money borrowed) may be taken from appellants, and appropriated for the enrichment of private collectors of rent, and for the benefit of tax units, whose taxable resources overlap in whole or in part the same territory, but who can not now tax any property of the Irrigation District, including land or personal property acquired by it for unpaid taxes.

Mr. Robert H. Jackson in his brief for the United States in the *U. S. v. Bekins* case, supra, at page 67 said:

> "The taxing agency, of course, is subject to the full control of the State, and its powers are *only*

those granted by the State. Unless these powers, expressly or by implication, include authority to compose its debts and to invoke the jurisdiction of the bankruptcy court, the taxing agency can not seek the benefit of the Act of August 16, 1937. Not only, therefore, is the choice of the taxing agency wholly voluntary, but it must necessarily be made subject to the provisions of the State law."

At page 83, Mr. Jackson also said:

"But in the case at bar the Lindsay-Strathmore Irrigation District is *not* a 'Political subdivision' of the State of California, and Chapter X is carefully constructed *to permit a separable operation."* (Emphasis ours.)

The relationship of "Public Trust" between this State Governmental agency, and its bondholders, taxpayers, land, water and power users are, in the light of these late California decisions, supra, such as to make Merced Irrigation District wholly outside the bankruptcy power, without impinging both on the reserved taxing and borrowing powers of the State. These bonds are recognized by the Treasury Department as wholly exempt from Federal Income tax.

In *U. S. v. Butler,* 297 U. S. 1, 68, the Court said:

"It is an established principle that the attainment of a prohibited end may not be accomplished under the pretext of the exertion of powers which were granted."

The doctrine of immunity on which the *Brush v. Commissioner,* 300 U. S. 352, rests, has not, we believe, been set aside by any later decision.

We need not enlarge upon the gravity of a subject, touching as directly the dual form of our Government, and the effect on credit, decided one way or the other when an attempt to repudiate such public obligations as are here before the Court, are sanctioned. The framers of our Constitution surely never intended that the power to decide such a question, for the States, with or without consent, is granted to the Congress.

In *Postal Tel. Co. v. Adams,* 155 U. S. 698, the Court said:

> "The substance, and not the shadow, determines the validity of the exercise of the power."

Without repeating arguments already made and authorities cited and other points raised in the briefs of other appellants, may we respectfully suggest that, after all, the main consideration is, in the light of the late California decisions, the total lack of power.

Therefore, we respectfully submit for these and the reasons discussed in the briefs of other appellants, the judgment of the Court below should be reversed, with directions to dismiss the proceeding.

Dated, San Francisco,
December 15, 1939.

Respectfully submitted,
PETER TUM SUDEN,
Attorney for Appellant,
Minnie Rigby, et al.